April 6, 2020

Weekly Macro & Markets View

Highlights and View

- **US initial jobless claims surge to 6'648'000 as COVID-19 hits the US with full force**

  Almost 10 million people in the US lost their jobs over the past two weeks, lifting the actual unemployment rate to roughly 10% with further layoffs ahead.

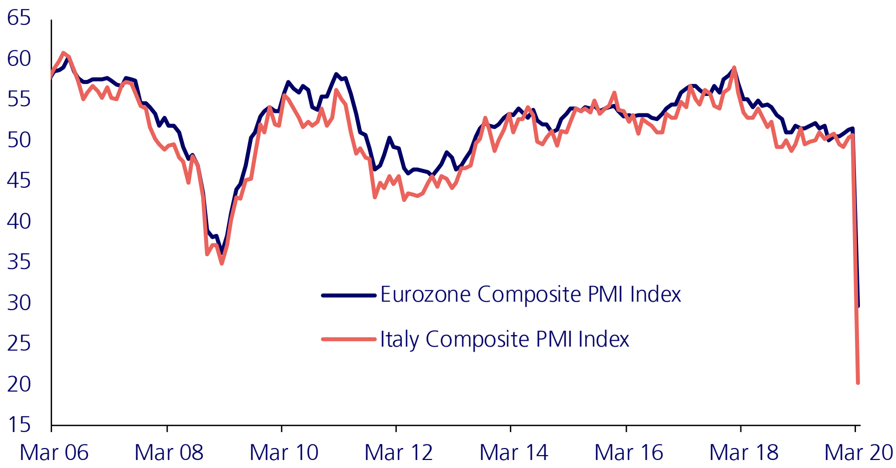
- **New virus case growth slows in western Europe, but Eurozone business confidence plummets in March**

  The flattening of the virus infection curve is a welcome development, but more policy support is needed given the hit to economic activity.

- **China's PMIs rebound significantly in March**

  While many industries are indeed recovering, China's economic path will remain bumpy.

Good and bad news in Europe last week



Source: Bloomberg

COVID-19 new case growth is now clearly slowing across much of continental Western Europe. This "flattening of the curve" is a prerequisite for even a partial lifting of lockdown restrictions and a gradual return to normal activity. However, evidence is also emerging that the hit to the economy has been gigantic. The March Eurozone Composite PMI was revised down further from its flash estimate, to 29.7, well below the worst levels during the Global Financial Crisis and the largest monthly drop on record. In Italy, where the lockdown was announced earlier in March than in most other European countries, the fall in the Composite PMI was even bigger. This highlights that as bad as the Eurozone survey was, it may not have fully captured the impact of virus containment measures. On a more positive note, Eurozone equities were only down around 2% on the week, suggesting that a lot of bad economic news may already be priced in. This Tuesday's Eurogroup meeting of Eurozone finance ministers will be critical in deciding next steps in terms of policy support. A combination of enhanced European Investment Bank loan guarantees, a credit facility from the ESM with minimal conditionality for individual countries, and adoption of the European Commission's proposal for a EUR 100bn Eurozone-wide unemployment insurance scheme is likely to be recommended. However, a commitment to some form of common bond issuance would also help in our view.

US: Jobless claims double from already unprecedented levels

Initial jobless claims surged to 6'648'000 according to data published last week as the COVID-19 wave now fully hits the US. That means almost 10 million people lost their jobs in the US over the last two weeks. The unemployment rate rose to 4.4% in March as nonfarm payrolls fell by 701'000. Unfortunately, this is just the tip of the iceberg as the survey reference period does not contain the second half of March. The true unemployment rate already lies at roughly 10% and is likely to rise further in the weeks ahead. Both the ISM Manufacturing as well as the Non-Manufacturing surveys fell less than expected in March with the former ticking down to 49.1 from 50.1 while the latter fell to 52.5 from 57.3. The relatively benign headline levels are somewhat misleading, however. Longer supplier deliveries, which are a sign of a stronger economy in normal circumstances, are distorting the indices. New orders have weakened substantially, indicating a sharp loss in momentum at the end of Q1.

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Japan: Tankan not as bad as expected, but likely to deteriorate further

Japan's quarterly corporate survey, the Tankan, showed a milder deterioration in Q1 than had been expected. However, most participants responded in late February, suggesting that worse numbers are still to come. The all-industry diffusion index for large enterprises fell from 9 to 0, with the outlook falling further to -6. These levels are far above the lows seen after the Global Financial Crisis or trough levels in the nineties. For smaller companies (an often-neglected category, even though these companies are important for Japan's labour market) the all-industry diffusion index fell from 1 to -7, while the outlook deteriorated sharply to -23. Considering that an announcement about a state of emergency and a lockdown for Tokyo is lingering we suspect that the Tankan's diffusion indices will fall further. Meanwhile, capex plans remain solid. On a separate note we are concerned about the deterioration on the COVID-19 front, where Japan had been faring better than other G20 nations. Consumer sentiment may also fall further following the death of a famous comedian due to the novel coronavirus.

Asia: PMIs tumble, while China's activity rebounds

Asian Manufacturing PMIs for March, excluding Japan and China, fell on average from about 50 to the mid-forties. If we exclude the distorting 'supplier delivery times' component, the aggregate PMI slipped another 3 points to about 43. Why? Under normal conditions, rising economic activity makes it more difficult for suppliers to deliver products on time. However, in March, supplier delivery times declined due to supply chain disruptions caused by COVID-19, and therefore the data do not reflect increased demand. The Philippine's PMI tumbled from 52.3 to 39.7 (or even 34 after adjustments), following the lockdown of the island of Luzon including its capital, Manila. Vietnam's PMI fell to a record low of 41.9. The leading 'new export order' component tumbled even more for most Asian countries. Meanwhile, China's PMIs spiked higher. For example, China's NBS Manufacturing PMI surged from 32.7 to 52. However, this reflects an improvement rather than a return to pre-crisis levels, due to the definition of a diffusion index, though we certainly recognize a remarkable improvement in some of China's manufacturing industries.

Equities: The tide may be turning, while oil prices experience a record bounce

Another week of angst for equity investors, with the MSCI World Index falling by 2.75%. Volatility did settle down a little, though it is still brutal on both a day-to-day and intra-day basis. The VIX measure fell back to 46.8 from the record high three weeks ago of 82, though, to put this in perspective, it is still at the highest levels since 2008. A key factor last week was the oil price, which had fallen early in the week to almost 70% down from the start of the year, before experiencing a record rally, jumping by 39% in two days. This was on hopes of a reconciliation between Russia and Saudi Arabia leading to potential output cuts. This provided a much-needed boost to the beleaguered oil sector, particularly in the US, where many of the shale producers are under significant financial pressure. We continue to expect equity volatility in the near term, as virus infections are still on the rise in the US, but we are encouraged by the breadth and depth of global support measures and the decline of infection rates in the Eurozone, which should improve market sentiment.

Credit: Sentiment normalises as supply surges

Policy stimulus and optimism around virus containment continues to underpin cash credit markets. US investment grade credit market supply surged once again setting a record for weekly issuance. The high yield primary market is also showing tentative signs of thawing, as inflows return. The energy sector was boosted last week by the jump in oil prices on hopes of co-ordinated production cuts. However, there was some caution amid the sharp fundamental deterioration that is expected. CDS spreads, for example, were notably wider last week, while cash spreads in the US have also started widening modestly after rallying almost 100bps since the Fed's policy announcements. New issue premiums remain elevated and some deals are getting a cold reception. Indeed, fundamentals remain under stress amid the high leverage built over the years. Bankruptcies are expected to rise, with S&P Global ratings expecting a 8% default rate in US high yield in 2020, which we think will be closer to 10%. While risks remain, valuations are discounting a fair bit of the downside already in our view.

What to Watch

- The MPCs of the central banks of Australia and Korea will convene. We expect both the RBA and the Bank of Korea to keep policy rates unchanged following their recent emergency cuts. Taiwan's exports are likely to have softened in March. We will take a closer look at semiconductor exports. Due to national holidays markets will be closed towards the end of this week and/or Monday next week in various APAC countries.
- In the US, the University of Michigan's consumer sentiment survey is likely to show a significant fall, and inflation is expected to show signs of weakening as economic momentum slows.
- The Eurozone highlight this week will be the Eurogroup meeting of finance ministers on Tuesday, when they will have a second chance to agree on recommendations for the further coordination of fiscal stimulus and loan guarantee measures.

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